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Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

GEORGE JERCICH,

Petitioner,

v.

JAMES PETRALIA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals In And For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

I. WHETHER LIABILITY FOR A BREACH OF AN EMPLOYMENT CONTRACT BY FAILURE TO PAY WAGES IS DISCHARGEABLE IN BANKRUPTCY.

LIST OF PARTIES

George Jercich

James Petralia

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PETITION FOR WRIT OF CERTIORARI

Petitioner George Jercich respectfully requests that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals, in and for the Ninth Circuit, entered on 23 January 2001, in the above-entitled proceeding.

OPINIONS BELOW

In re George Jercich, 238 F.3d 1202 (9th Cir. 2001), reprinted in the Appendix. (App. 1)

In re George Jercich, 243 B.R. 747 (9th Cir. B.A.P. 2000), reprinted in the Appendix. (App. 16)

James Petralia v. George Jercich, Inc., et al., Unpublished Opinion, Superior Court of California in and for the County of Monterey, filed 14 February 1984, reprinted in the Appendix. (App. 26)

JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals in and for the Ninth Circuit was entered on 23 January 2001. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C § 523(a)(6)

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
>
> . . .
>
> > (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;
>
> . . .

11 U.S.C. § 507(a)(3)

> (a) The following expenses and claims have priority in the following order:
>
> . . .
>
> > (3) Third, allowed unsecured claims, but only to the extent of $4,000 for each individual or corporation, as the case may be, earned within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for –
> >
> > > (A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or
> > >
> > > (B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding

> that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor;
>
> . . .

STATEMENT OF THE CASE

James Petralia obtained a judgment against George Jercich for failure to pay wages in California state court on 14 February 1984, finding that Mr. Jercich had the ability to pay the wages but chose not to do so. (App. 26, 28) The Court made the additional finding that Mr. Jercich had breached the covenant of good faith and fair dealing, and awarded punitive damages pursuant to California Civil Code section 3294[1], stating that "[t]his failure

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[1] California Civil Code section 3294 provides in relevant part:

> (a) In an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.
>
> . . .
>
> (c) As used in this section, the following definitions shall apply:
>
> . . .
>
> (2) "Oppression" means despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights.

to pay was willful and deliberate and constituted substantial oppression entitling the court to award punitive damages." (App. 30)

During the pendency of Mr. Jercich's appeal to the California Court of Appeal, he filed a Chapter 7 bankruptcy petition, and after the California Court of Appeal affirmed the judgment, Mr. Petralia initiated an adversary proceeding to have the state court judgment declared nondischargeable pursuant to 11 U.S.C. § 523(a)(6). (App. 3)

During the pendency of the proceedings, the California Supreme Court abrogated the availability of punitive damages in the employment setting, (App. 8, 23-24), stating:

> As we have reiterated, the employment relationship is fundamentally contractual, and several factors combine to persuade us that in the absence of legislative direction to the contrary contractual remedies should remain the sole available relief for breaches of the implied covenant of good faith and fair dealing in the employment context.

(*Foley v. Interactive Data Corporation*, 47 Cal.3d 654, 696 [254 Cal.Rptr. 211, 236-37, 765 P.2d 373, 398] (Cal. 1988))

Foley was made retroactive to all cases not yet final on 30 January 1989. (*Newman v. Emerson Radio Corporation*, 48 Cal.3d 973, 976 [258 Cal.Rptr. 592, 593, 772 P.2d 1059, 1072] (Cal. 1989))

The bankruptcy court determined that the debt was dischargeable because there was no state court finding that Mr. Jercich had the specific intent to harm Mr.

Petralia, citing this Court's opinion in *Kawaauhau v. Geiger*, 523 U.S. 57 [118 S.Ct. 974, 140 L.Ed.2d 90] (1998). (App. 3-4)

The United States Bankruptcy Appellate Panel for the Ninth Circuit, in a published decision, affirmed. (*In re Jercich*, 243 B.R. 747 (9th Cir. B.A.P. 2000); App. 16-25) That court held that because many, if not most, breaches of contract are intentional "the liability for the tort is independent of the liability on the contract." (App. 20) The court explained:

> Limiting the scope of § 523(a)(6) in this way will assure that ordinary breaches of contract, which are often willful, are not made dischargeable by state laws that have sometimes extended tort liability beyond the traditional view. In our view, § 523(a)(6) was never intended to extend to claims that are in actuality claims for breach of contract, but which state law has denominated as torts.

(App. 22)

The decision was appealed to the Ninth Circuit Court of Appeals, which reversed. (*In re Jercich*, 238 F.3d 1202 (9th Cir. 2001); App. 1-15) That court held that since the failure to pay wages violated a fundamental public policy of the State of California, the willful failure to pay wages constituted a tort despite the fact that no California court has ever so held. (App. 8-10) The Court went on to find that the injury to Mr. Petralia was willful and malicious because the injury from the failure to pay wages was substantially certain to occur and was done without just cause or excuse. (App. 11-15)

REASONS FOR GRANTING THE WRIT

I

THE COURT OF APPEALS HAS DECIDED AN IMPORTANT ISSUE OF FEDERAL LAW THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THE SUPREME COURT.

A. INTRODUCTION

Just three years ago in *Kawaauhau v. Geiger*, 523 U.S. 57, [118 S.Ct. 974, 140 L.Ed.2d 90] (1998) this Court held that only acts done with the actual intent to cause injury are not subject to discharge pursuant to the requirement for willful and malicious injury pursuant to 11 U.S.C. § 523(a)(6)[2]. This requirement for exception to discharge in bankruptcy has been a part of our bankruptcy laws since the passage of the Bankruptcy Act of July 1, 1898, and had been reviewed by this Court on only three prior occasions. (*Davis v. Aetna Acceptance Company*, 293 U.S. 328 [55 S.Ct. 151, 79 L.Ed. 393] (1934); *McIntyre v. Kavanugh*, 242 U.S. 138 [37 S.Ct. 38, 61 L.Ed. 205] (1916); *Tinker v. Colwell*, 193 U.S. 473 [24 S.Ct. 505, 48 L.Ed. 754] (1904)) The Ninth Circuit Court of Appeals in this case has decided an important federal question that was left unaddressed in this Court's prior decisions and must be addressed now because it represents an issue of national importance; it has ruled that an abrogated state law "tort" for breach of an employment contract is not subject to discharge pursuant to section 523(a)(6). Upon close

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[2] All further references to Title 11 of the United States Code will be designated "section".

inspection, however, the Ninth Circuit's decision in reality holds that a failure to pay wages by an employer is *never* subject to discharge regardless of fault because most, if not all, such claims fall into the Court of Appeals' definition of "willful and malicious". As will be shown, this decision will have a tremendous impact on bankruptcy litigation across the country by inviting every employee to file an adversary proceeding in order to avoid the priority (and eventual discharge) provided by section 507(a)(3), thereby choking the bankruptcy courts with contract claims in tort clothing. This Petition must be granted to stem this incoming tide by instructing the lower courts that section 523(a)(6) was indeed intended to cover torts and not breaches of contracts.

B. THE NINTH CIRCUIT OPINION CREATES A FORMULATION FOR A BANKRUPT EMPLOYER'S FAILURE TO PAY WAGES THAT RENDERS THOSE WAGES NONDISCHARGEABLE IN EVERY INSTANCE.

There can be no question that the employment relationship is fundamentally a contractual one. (*Hishon v. King & Spalding*, 467 U.S. 69, 74-75 [104 S.Ct. 2229, 2233-34, 81 L.Ed.2d 59] (1984); *Coppage v. Kansas*, 236 U.S. 1, 14 [35 S.Ct. 240, 243, 59 L.Ed. 441] (1915)) The linchpin of the Court of Appeals' reasoning is that under California law prompt payment of wages on termination of employment is a fundamental public policy, and that violation of this public policy is tortious and therefore at least potentially within the ambit of section 523(a)(6). (App 8-10) Virtually every state in the union has similar

laws regarding payment of wages[3], and therefore at a minimum the potential now exists that across the country adversary actions will be filed to determine that each and every wage claim is nondischargeable on the theories espoused by the Ninth Circuit in this case.

The flaw in the Ninth Circuit's reasoning is its fundamental departure from basic legal principles. This Court has made clear that section 523(a)(6) requires an *intentional tort* in order for its provisions to apply. (*Kawaauhau v. Geiger*, 523 U.S. 57, 61-62 [118 S.Ct. 974, 977, 140 L.Ed.2d 90] (1998)) It is self evident that an "intentional tort" is a subset of torts in general. A "tort" is defined as

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[3] See generally, Alaska Stat. § 23.05.140; Ariz. Rev. Stat. Ann. §§ 23-353, 23-360; Ark. Code Ann. § 11-4-405; Cal. Lab. Code §§ 202, 203; Colo. Rev. Stat. § 8-4-104; Conn. Gen. Stat. Ann. § 31-71c; Ga. Code Ann. § 34-7-4; Haw. Rev. Stat. § 388-3; Ill. Rev. Stat. ch. 48, p. 39-m5; Kan. Stat. Ann. § 44-315; La. Rev. Stat. Ann. §§ 23:631, 23:632; Mass. Gen. Laws Ann. ch. 149, § 148; Mich. Comp. Laws Ann. §§ 408.471 et seq., 600.2919(a); Minn. Stat. Ann. §§ 181.08, 181.13, 181.14; Mont. Code Ann. § 39-3-205; Nev. Rev. Stat. §§ 608.030, 608.040; N.H. Rev. Stat. Ann. § 275:44; N.M. Stat. Ann. § 60-4-4; N.D. Cent. Code § 34-14-03; Ohio Rev. Code Ann. § 4113.15; Or. Rev. Stat. § 652.140; R.I. Gen. Laws § 28-14-4; S.C. Code Ann. § 41-10-10; S.D. Codified Laws Ann. § 60-11-10; Tex. Rev. Civ. Stat. Ann. § 5156; Utah Code Ann. § 34-28-5; Vt. Stat. Ann. tit. 21, § 342; W. Va. Code § 21-5-4; Wis. Stat. Ann. § 109.03(2); Wyo. Stat. § 27-4-104; see also, Emmanuel S. Tipon and Martin J. McMahon, Annotation, *Validity, Construction, and Effect of State Laws Requiring Payment of Wages on Discharge of Employee Immediately or Within Specified Period*, 18 A.L.R.5th 577 (1994); Emmanuel S. Tipon, Annotation, *Validity, Construction, and Effect of State Laws Requiring Payment of Wages on Resignation of Employee Immediately or Within Specified Period*, 11 A.L.R.5th 715 (1993)

"[a] legal wrong committed upon the person or property *independent of contract.*" (Black's Law Dictionary 1335 (5th ed. 1979) (emphasis added))

> Torts have traditionally been defined as obligations giving rise to liability that are imposed by law apart from and independent of enforcement of promises made between parties to a contract. (W. Page Keeton, et al., *Prosser and Keeton on Torts*, § 92, at 655-56 (5th ed. 1984)) In contrast, contract obligations are created to enforce promises to do or not to do something and are obligations "based on the manifested intention of the parties to a bargaining transaction." (*Id.*)

(App. 19-20)

This Court has strongly suggested a "knowing breach of contract" should *not* be excepted from discharge because "[a] construction so broad would be incompatible with the 'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed.' (Citation)" (*Kawaauhau v. Geiger*, 523 U.S. 57, 62 [118 S.Ct. 974, 977, 140 L.Ed.2d 90] (1998)) The Ninth Circuit in its opinion has clearly ignored the suggestion and instead violates the "well-known guide".

The Ninth Circuit approach is also flawed when it states that it looks to state law to determine whether the conduct in question is a tort. (App. 8) The history of this case and California state law show the danger in this approach: state law can change and with respect to "public policy" torts, (see *Foley v. Interactive Data Corporation*, 47 Cal.3d 654, 696 [254 Cal.Rptr. 211, 236-37, 765 P.2d 373, 398] (Cal. 1988)), and there is a very real danger of inconsistency not only through time but also across state

lines. Thus, a bankrupt employer in Nevada may be able to discharge a wage claim that an identically situated California employer may not be able to discharge. Proceeding to its logical conclusion, a multi-state employer might have to treat employees from different states differently in the bankruptcy proceeding, and this in and of itself might foster additional litigation to determine which state's law applies to the employees across the board. This Court has implicitly recognized this in its prior decisions regarding discharge of alleged "willful and malicious injury". In *Kawaauhau, supra, Davis, supra, McIntyre, supra,* and *Tinker, supra,* this Court examined the *common law* of torts in order to determine if the particular acts were subject to discharge. In affirming the Eighth Circuit in *Kawaauhau, supra,* this Court implicitly upheld the following holding:

> We therefore think that the correct rule is that a judgment debt cannot be exempt from discharge in bankruptcy unless it is based on what the law has for generations called an intentional tort, a legal category that is based on "the consequences of an act rather than the act itself." (Restatement (Second) Torts, § 8A, comment a, at 15 (1965)) Unless the actor "desires to cause consequences of his act, or . . . believes that the consequences are substantially certain to result from it," he or she has not committed an intentional tort. (*Id.* § 8A at 15)

(*In re Geiger,* 113 F.3d 848, 852 (8th Cir. 1997))

Additionally, this Court's reliance on the Restatement (Second) of Torts is telling. *Nowhere* in the Restatement is it provided that a breach of contract is a tort, but the Restatement deals extensively with the "traditional"

intentional torts such as fraud, battery, and conversion. The closest that the Restatement comes to breach of contract claims is section 874A for Tort Liability for Violation of Legislative Provision. But that section by its own terms is inapplicable because it is limited to a statute "that does not provide a civil remedy. . . ." (Restatement (Second) Torts, § 874A) The statutes for failure to pay wages almost always provide for a civil remedy, therefore rendering that section inapplicable.

Therefore, for purposes of the "willful and malicious injury" requirement of section 523(a)(6), as this Court has made clear, lower courts should look to traditional intentional torts and not breach of contract styled torts for purposes of nondischargeability. This of course also makes practical sense as well, because using tort-based tests in breach of contract settings leads to absurd and dangerous results such as those here. As will be shown, the Ninth Circuit formulation for "willful and malicious injury" leads to nondischargeability *in every failure-to-pay wages case*.

The fundamental problem with the Ninth Circuit's formulation is that it attempts to use tort principles to characterize contract conduct. The difference between traditional torts and contract breaches are the certainty of the victim and the injury. In a tort setting, one can commit the willful act but still have no "victim" nor injury. That is impossible in a contract breach scenario. By definition, the contract has parties, and every breach such as a failure to pay wages will certainly result in an injury to the non-breaching party in the form of non-payment. By the Ninth Circuit's reasoning, that fulfills the "willfulness" prong *every time* because the breach – the failure to

pay wages – is *always* substantially certain to cause injury. Likewise, the Ninth Circuit test for maliciousness is that the act "is done without just cause or excuse". (App. 14) But, again *by definition*, a breach of contract is a "[f]ailure, without legal excuse, to perform any promise which forms the whole or part of a contract." (Black's Law Dictionary 171 (5th ed. 1979); see also Restatement (Second) Contracts, §§ 235(2), 236) Therefore, under the Ninth Circuit view, because *every* breach is done without just cause or excuse, *every* breach of contract is also "malicious". Therefore, absent intervention by this Court, *every* failure to pay wages claim has become nondischargeable under section 523(a)(6)

C. THE NINTH CIRCUIT FORMULATION FOR NONDISCHARGEABILITY OF WAGES IMPERMISSIBLY RENDERS 11 U.S.C. § 507(A)(3) A NULLITY.

Finally, the Ninth Circuit formulation renders the wage priority provisions of section 507(a)(3) a nullity because, as demonstrated, every failure to pay wages claim has become nondischargeable. "It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.' (Citation)" (*Food and Drug Administration v. Brown & Williamson Tobacco Company*, 529 U.S. 120, ___ [120 S.Ct. 1291, 1301, 146 L.Ed.2d 121] (2000))

> Congress is not to be presumed to have used words for no purpose. . . . But the admitted rules of statutory construction declare that a

> legislature is presumed to have used no superfluous words. Courts are to accord a meaning, if possible, to every world in a statute. In *Commonwealth v. Alger* (7 Cush. (Mass.) 53-89), it was said that in putting a construction upon any statute every part must be regarded, and it must be so expounded, if practicable, as to give some effect to every part of it.

(*Platt v. Union Pacific Railroad*, 99 U.S. 48, 58-59 [25 L.Ed. 424] (1878))

Thus, under these rules of statutory construction, the new test for discharge of wage claims must fail because it renders section 507(a)(3) superfluous and a nullity.

Additionally, the Ninth Circuit formulation flies in the face of the legislative history of the "willful and malicious injury" exception to discharge. The codification of section 523(a)(6) was done in conjunction with the repeal of former 11 U.S.C. § 35(a)(5) which provided that wages earned within three months of the bankruptcy petition were nondischargeable. By repeal of that section, Congress made clear that wages are in fact dischargeable, and thus the new Ninth Circuit formulation which, as shown, renders nondischargeable *every* failure to pay wage claims is clearly contrary to the Congressional mandate. " . . . [W]here Congress has made its intent clear, '[this Court] must give effect to that intent.' (Citation)" (*Miller v. French*, ___ U.S. ___ [120 S.Ct. 2246, 2253, 147 L.Ed.2d 326] (2000))

The intent of Congress is clear. By repealing its former provisions and enacting sections 507(a)(3) and 523(a)(6), Congress clearly and unmistakably provided

that wages were in fact contract debts subject to discharge. The Ninth Circuit formula in this case clearly and impermissibly flies in the face of that intent.

II

THIS CASE REPRESENTS AN ISSUE OF NATIONAL IMPORTANCE.

As explained above, the Ninth Circuit has broken new ground in this decision that will affect virtually every employer that files for bankruptcy in this nation. Rather than filing a claim for wages in the orderly course of the proceedings, every employee will be invited to file an adversary proceeding to determine that his or her wages are not subject to the bankruptcy, regardless of the conduct of the employer. Already overcrowded bankruptcy dockets will swell with these proceedings, turning these courts into trial courts when they have never really been designed to so function. And, by its overbroad formulation, the Ninth Circuit has swept into court the "honest but unfortunate debtor" that it acknowledges the bankruptcy laws were designed to protect, with no hope for the true discharge that the law promises. This Petition must be granted to provide the correct standard for the courts below and prevent the inevitable flood of litigation the Ninth Circuit has unleashed.

CONCLUSION

George Jercich respectfully requests that for the reasons stated above this Petition for Writ of Certiorari be granted.

Respectfully Submitted,

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App. 1

United States Court of Appeals,
Ninth Circuit.

In re George JERCICH, Debtor.
James A. Petralia, Appellant,
v.
George Jercich, Appellee.

No. 00-15300.

Argued and Submitted Dec. 13, 2000.
Filed Jan. 23, 2001.

Thomas R. Duffy and Ralph P. Guenther, Duffy & Guenther, Monterey, California, for the appellant.

Thomas D. Patrick, Redding, California, for the appellee.

Appeal from the Ninth Circuit Bankruptcy Appellate Panel Perris, Ryan and Meyers, Judges, Presiding. BAP No. NC-98-01724-PRyMe.

Before: RYMER, T.G. NELSON and WARDLAW, Circuit Judges.

T.G. NELSON, Circuit Judge:

James A. Petralia appeals the Bankruptcy Appellate Panel ("BAP") affirmance of the Bankruptcy Court's order granting judgment in favor of debtor George Jercich in Petralia's action seeking to have a debt excepted from discharge under 11 U.S.C. § 523(a)(6). We have jurisdiction under 28 U.S.C. § 158(d). We reverse.

I.

The underlying facts of this case are undisputed. From June 1981 to January 1983, Petralia was employed

by George Jercich, Inc., a real estate company wholly owned and operated by debtor Jercich. The company performed mortgage broker services, and Petralia's primary duty was to obtain investors to fund loans arranged by Jercich. Pursuant to an employment agreement between Petralia and Jercich, Petralia was to be paid a salary plus a commission for loans which were funded through his efforts. The commissions were to be paid on a monthly basis.

Jercich failed to pay Petralia his commissions as required under the employment agreement. Petralia quit his employment with Jercich in January 1983 and in February 1983 filed an action against Jercich in California state court. In this action, Petralia sought to recover, among other things, unpaid wages, "waiting time penalties" (penalties imposed on employers under California law for failure to timely pay employees), and punitive damages.

After a bench trial, the state court granted judgment in favor of Petralia. The court found that Jercich had not paid Petralia commissions and vacation pay as required under the employment contract; that "Jercich had the clear ability to make these payments to Petralia, but chose not to"; that instead of paying Petralia and other employees the money owed to them, "Jercich utilized the funds from his company to pay for a wide variety of personal investments, including a horse ranch"; and that Jercich's behavior was willful and amounted to

oppression within the meaning of California Civil Code § 3294.[1] The state court held, in relevant part, (1) that Petralia was entitled to his unpaid wages; (2) that Jercich owed Petralia waiting time penalties; and (3) that because Jercich's failure to pay was willful and deliberate and "constituted substantial oppression," punitive damages would be assessed against Jercich in the amount of $20,000.00. The state trial court's judgment against Jercich was affirmed by the California Court of Appeal in an opinion filed in May 1986.

While the appeal of the state trial court judgment was pending, Jercich filed a Chapter 7 bankruptcy petition. In November 1986, after the state trial court judgment had been affirmed on appeal, Petralia initiated the present adversary proceeding seeking to have the state court judgment excepted from discharge under 11 U.S.C. § 523(a)(6).[2]

The bankruptcy court resolved the adversary proceeding in favor of Jercich. The court found that under the U.S. Supreme Court's decision in *Kawaauhau v. Geiger*,[3] "the state court . . . would have had to find that Mr. Jercich . . . did what he did with a specific intent, to use a

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[1] California Civil Code § 3294 allows imposition of exemplary (punitive) damages "[i]n an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice."

[2] Section 523(a)(6) provides: "A discharge under . . . this title does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity."

[3] 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998).

criminal law term, of harming [Petralia]. But no such finding was made, nor can that conclusion be inferred from the findings that were made by the state court." The bankruptcy court therefore held that the debt was dischargeable.

BAP affirmed in a published opinion, but for different reasons than stated by the bankruptcy court. BAP held that "where a debtor's conduct constitutes both a breach of contract and a tort, the debt resulting from that conduct does not fit within § 523(a)(6) unless the liability for the tort is independent of the liability on the contract."[4] Defining a tort as "independent" only "if the conduct at issue would be tortious even if a contract between the parties did not exist," BAP concluded that there was not a tort independent of the contract and that the debt was not, therefore, excepted from discharge under § 523(a)(6).[5]

II.

"We review independently the decision of the bankruptcy court, showing no deference to the decision of the BAP. We review de novo the bankruptcy court's conclusions of law, and we review for clear error the bankruptcy court's findings of fact."[6]

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[4] *In re Jercich*, 243 B.R. 747, 751 (9th Cir.BAP 2000).

[5] *Id.*

[6] *In re Kadjevich*, 220 F.3d 1016, 1019 (9th Cir.2000) (citation omitted).

III.

Section 523(a)(6) excepts from discharge debts resulting from "willful and malicious injury by the debtor to another entity or to the property of another entity."[7] In *In re Riso*, we recognized that "a simple breach of contract is not the type of injury addressed by § 523(a)(6)"[8] and held that "[a]n intentional breach of contract is excepted from discharge under § 523(a)(6) only when it is accompanied by malicious and willful *tortious conduct*."[9]

By holding, in the present case, that the debt was not excepted from discharge under § 523(a)(6), BAP imposed an additional requirement: not only must there be tortious conduct, but according to BAP, this conduct must be "tortious even if a contract between the parties did not exist."[10] We disagree with the imposition of this additional requirement.

First, there is nothing in the language of § 523(a)(6) to indicate that a debt arising from a breach of contract is excepted from discharge only if the debtor's conduct

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[7] 11 U.S.C. § 523(a)(6).

[8] 978 F.2d 1151, 1154 (9th Cir.1992).

[9] *Id.* (emphasis added) (citing *In re Moultrie*, 51 B.R. 368, 373-74 (Bankr.W.D.Wash.1985) (noting that "[o]nly debts arising from tortious acts are nondischargeable under § 523(a)(6)" but recognizing that acts involving "breach of contract . . . may also involve tortious acts such as interference with contract relations"); *In re Haynes*, 19 B.R. 849, 851 (Bankr.E.D.Mich.1982) ("[A] debt arising out of a mere breach of contract absent any showing that the purpose of the breach was to cause injury is not a non-dischargeable debt within the meaning of § 523(a)(6).")).

[10] *In re Jercich*, 243 B.R. 747, 751 (9th Cir.BAP 2000).

would be tortious even if no contract existed.[11] To the contrary, although § 523(a)(6) *generally* applies to torts rather than to contracts[12] and an intentional breach of contract *generally* will not give rise to a nondischargeable debt, where an intentional breach of contract is accompanied by tortious conduct which results in willful and malicious injury, the resulting debt is excepted from discharge under § 523(a)(6).[13]

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[11] Although some courts have used the term "independent tort" in analyzing whether a debt arising from a breach of contract is excepted from discharge under § 523(a)(6), *see, e.g., In re Akridge*, 71 B.R. 151, 154 (Bankr.S.D.Cal.1987), none of those courts have defined the term in the same manner as BAP – that a tort is independent only "if the conduct at issue would be tortious even if a contract between the parties did not exist." 243 B.R. at 751. For purposes of clarity, we avoid the use of the term "independent tort" and focus instead on whether the debtor engaged in tortious conduct that resulted in willful and malicious injury.

[12] 4 Collier on Bankruptcy ¶ 523.12 (15th ed. rev.2000).

[13] *See Riso*, 978 F.2d at 1154; *In re Trammell*, 172 B.R. 41 (Bankr.W.D.Ark.1994) (excepting from discharge under § 523(a)(6) a debt arising out of a breach of the covenant not to compete); *In re Ketaner*, 149 B.R. 395 (Bankr.E.D.Va.1992) (same); *see also In re Smith*, 160 B.R. 549, 553-54 (N.D.Tex.1993) ("[I]t was not necessary for the bankruptcy court to find that [the debtors'] actions constituted an independent tort other than fraud in order to hold the [debt to the plaintiff] nondischargeable pursuant to § 523(a)(6). The bankruptcy court was only required to find that [the debtors'] willful and malicious conduct caused damage to the [plaintiff]."); *In re Moultrie*, 51 B.R. 368, 373-74 (Bankr.W.D.Wash.1985) (noting that "[o]nly debts arising from tortious acts are nondischargeable under § 523(a)(6)," but that acts involving breach of contract "may also involve tortious acts such as interference with contract relations"); *In re Haynes*, 19 B.R. 849, 851 (Bankr.E.D.Mich.1982) ("[A] debt arising out of a

Moreover, one of the fundamental policies of bankruptcy law is to give a fresh start only to the "honest but unfortunate debtor."[14] In fact, Congress's decision to make the debts listed under § 523(a) nondischargeable "reflect[s] a decision by Congress that the fresh start policy is not always paramount. For example, some of the exceptions to discharge in § 523(a) are based on a corollary of the policy of giving honest debtors a fresh start, which would be to deny dishonest debtors a fresh start. *See e.g.*, 11 U.S.C. §§ 523(a)(1), (2), (4), (6), and (12)."[15] Allowing discharge of debts simply because the tortious conduct at issue would not be tortious in the absence of a contract would negate this fundamental policy.

We therefore hold that to be excepted from discharge under § 523(a)(6), a breach of contract must be accompanied by some form of "tortious conduct" that gives rise to "willful and malicious injury." In so holding, we reject BAP's imposition of a requirement that the conduct at issue be tortious even if a contract between the parties did not exist.

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mere breach of contract absent any showing that the purpose of the breach was to cause injury is not a non-dischargeable debt within the meaning of § 523(a)(6)."); *In re Rivera*, 238 F.Supp. 233, 234 (S.D.N.Y.1965) ("[T]he theory of recovery – tort or contract – is immaterial [to the § 523(a)(6) inquiry].").

[14] *Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (noting that while the "fresh start" is "a central purpose of the [Bankruptcy] Code," this opportunity is limited to the " 'honest but unfortunate debtor' "); *In re Bugna*, 33 F.3d 1054, 1059 (9th Cir.1994) (same).

[15] *In re Janc*, 251 B.R. 525, 543-44 (Bankr.W.D.Mo.2000).

IV.

A. *Tortious Conduct*

To determine whether Jercich's conduct was tortious, we look to California state law.[16] Under California law, "[c]onduct amounting to a breach of contract becomes tortious only when it also violates an independent duty arising from principles of tort law."[17]

Outside the area of insurance contracts, tort recovery for the bad faith breach of a contract is permitted only when, "in addition to the breach of the covenant [of good faith and fair dealing] a defendant's conduct violates a fundamental public policy of the state."[18] The California

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[16] *See In re Bailey*, 197 F.3d 997, 1000 (9th Cir.1999) ("While bankruptcy law governs whether a claim is nondischargeable under § 523(a)(6), this court looks to state law to determine whether an act falls within the tort of conversion.").

[17] *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal.4th 503, 28 Cal.Rptr.2d 475, 869 P.2d 454, 460 (In Bank). At the time of the state court judgment, the breach of the covenant of good faith and fair dealing in employment contracts was deemed to also constitute a tort. Since that time, the California Supreme Court has held that tort remedies are not necessarily available for breach of the implied covenant of good faith and fair dealing in the employment setting. *Foley v. Interactive Data Corp.*, 47 Cal.3d 654, 254 Cal.Rptr. 211, 765 P.2d 373, 401 (In Bank); *see Newman v. Emerson Radio Corp.*, 48 Cal.3d 973, 258 Cal.Rptr. 592, 772 P.2d 1059, 1060 (In Bank) (holding that the rule announced in "*Foley* is fully retroactive, applying to all cases not yet final as of January 30, 1989, the date the decision in *Foley* became final."). As discussed below, however, the breach at issue in this case – the willful nonpayment of wages – can constitute tortious conduct even under present California law.

[18] *Rattan v. United Servs. Auto. Assoc.*, 84 Cal.App.4th 715, 101 Cal.Rptr.2d 6, 11; *see Applied Equip.*, 28 Cal.Rptr.2d 475, 869

Court of Appeal has held that "the prompt payment of wages due an employee is a fundamental public policy" in California.[19] As that court explained:

> Public policy has long favored the full and prompt payment of wages due an employee. Wages are not ordinary debts. Because of the economic position of the average worker and, in particular, his family, it is essential to the public welfare that he receive his pay promptly. Thus, the prompt payment of wages serves society's interest through a more stable job market, in which its most important policies are safeguarded.
>
> Labor Code section 216, subdivision (a) provides any 'employer who, having the ability to pay, willfully refuses to pay wages due and payable after demand has been made is guilty of a misdemeanor. The Legislature's decision to criminalize violations of the prompt payment policy also supports [the conclusion that the policy for full and prompt payment of wages] involves a broad public interest, not merely the interest of the employee.[20]

P.2d at 460 (noting that California law imposes an obligation binding every person "to abstain from injuring the person or property of another, or infringing upon any of his rights"; that this "duty is independent of the contract"; and that the "omission to perform a contract obligation is never a tort, unless that omission is also an omission of a legal duty") (citations, quotations and ellipses omitted).

[19] *Gould v. Maryland Sound Indus., Inc.*, 31 Cal.App.4th 1137, 37 Cal.Rptr.2d 718, 723 (holding that discharge to avoid payment of wages is cognizable in tort as a wrongful discharge).

[20] *Id.* at 723-24 (quotations, citations and ellipses omitted).

In the present case, the state trial court found that Jercich had the "clear ability" to pay Petralia his wages when they were due, but willfully "chose not to" in violation of California law.[21] The court also found that Jercich's acts amounted to oppression under California Civil Code § 3294, which by definition must involve "despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights."[22] As the court explained: "Few, if any, areas of the law are more important than an employer's obligation to pay his employee's wages. California courts agree, and have time and again underscored the significance of an employer's failure to pay wages."

Based on these state court findings, we hold that Jercich's nonpayment of wages under the particular circumstances of this case constituted tortious conduct.

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[21] The state court specifically cited California Labor Code § 203, which provides in relevant part: If an employer willfully fails to pay . . . any wages of an employee who . . . quits, the wages of the employee shall continue as a penalty from the due date thereof at the same rate until paid or until an action therefor is commenced; but the wages shall not continue for more than 30 days.

Cal. Labor Code § 203. From the state court's findings, it is clear that Jercich also violated California Labor Code § 216, which makes it a misdemeanor for an employer, having the ability to pay, to willfully refuse to pay wages due and payable after demand for the wages has been made.

[22] Cal. Civil Code § 3294(c)(2); *Applied Equip.*, 28 Cal.Rptr.2d 475, 869 P.2d at 461.

B. *Willful and Malicious Injury*

1. *Willfulness*

Citing *Kawaauhau v. Geiger*,[23] Jercich argues, and the district court held, that to meet the willfulness prong of § 523(a)(6), Jercich had to have withheld the wages with the "specific intent" of harming Petralia. We disagree.

In *Geiger*, the U.S. Supreme Court held that debts arising out of a medical malpractice judgment, i.e., "debts arising from reckless or negligently inflicted injuries," do not fall within § 523(a)(6)'s exception to discharge.[24] In so holding, the Court clarified that it is insufficient under § 523(a)(6) to show that the debtor *acted* willfully and that the injury was negligently or recklessly inflicted; instead, it must be shown not only that the debtor *acted* willfully, but also that the debtor inflicted the *injury* willfully and maliciously rather than recklessly or negligently.[25]

In *Geiger*, the Court did not answer the question before us today – the precise state of mind required to satisfy § 523(a)(6)'s "willful" standard. The *Geiger* Court did, however, cite with approval its prior decision of *McIntyre v. Kavanaugh*[26] and the Restatement (Second) of Torts § 8A, cmt. A, p. 15 (1964).

In *McIntyre*, the debt arose from the debtor's conversion of the creditor's property. Holding that this debt was excepted from discharge under § 523(a)(6), the Court

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[23] 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998).

[24] *Id.* at 59, 64.

[25] *See id.* at 64.

[26] 242 U.S. 138, 37 S.Ct. 38, 61 L.Ed. 205 (1916).

indicated that a wrongful act that is voluntarily committed with knowledge that the act is wrongful and will necessarily cause injury meets the "willful and malicious" standard of § 523(a)(6).[27] Similarly, the Restatement definition of intent cited by the *Geiger* Court requires the actor either to desire the consequences of an act or to know the consequences are substantially certain to result. Under this definition, the actor's deliberate act with knowledge that the act is substantially certain to cause injury is sufficient to establish willful intent.[28]

This definition is consistent with the approach this court took in the post-*Geiger* case of *In re Bailey*,[29] where we stated that "[t]he conversion of another's property without his knowledge or consent, done intentionally and without justification and excuse, to the other's injury, constitutes a willful and malicious injury within the meaning of § 523(a)(6)."[30] Similarly, the Fifth Circuit has held *Geiger* to be satisfied where "the debtor intentionally took action that necessarily caused, or was substantially certain to cause, the injury."[31] In other words, under the Fifth Circuit's approach, an injury is "willful" under § 523(a)(6) if the debtor's motive was to inflict the injury *or* the debtor's act was substantially certain to result in injury.[32]

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[27] *Id.* at 141-42.

[28] *See id.*

[29] 197 F.3d 997, 1000 (9th Cir.1999).

[30] *Id.* at 1000 (quoting *Transamerica Comm. Fin. Corp. v. Littleton*, 942 F.2d 551, 554 (9th Cir.1991)).

[31] *In re Miller*, 156 F.3d 598, 604 (5th Cir.1998).

[32] *Id.*

The Sixth Circuit has also held, post-*Geiger*, that a debtor must will or desire the harm, or believe that injury is substantially certain to occur as a result of his behavior before a resulting debt will be excepted from discharge under § 523(a)(6).[33] Finally, at least one Ninth Circuit BAP panel has held that either substantial certainty that injury will result or subjective motive to inflict injury meets the post-*Geiger* requirement of "willful injury" under § 523(a)(6).[34]

We hold, consistent with the approaches taken by the Fifth and Sixth Circuits, that under *Geiger*, the willful injury requirement of § 523(a)(6) is met when it is shown either that the debtor had a subjective motive to inflict the injury *or* that the debtor believed that injury was substantially certain to occur as a result of his conduct. We believe that this holding comports with the purpose bankruptcy law's fundamental policy of granting discharges only to the honest but unfortunate debtor.[35]

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[33] *In re Markowitz*, 190 F.3d 455, 465 n. 10 (6th Cir.1999). The Sixth Circuit noted, however, that it is not enough that the debtor *should have known* his decisions and actions put another at risk for injury; rather, to be excepted from discharge under § 523(a)(6), the debtor must actually will or desire the harm or have knowledge that the harm is substantially certain to occur. *Id.*

[34] *In re Baldwin*, 245 B.R. 131, 136 (9th Cir.BAP 2000).

[35] Moreover, imposing a specific intent requirement as urged by Jercich would produce absurd results that could not possibly have been intended by Congress. For example, if a showing of specific intent were required, a debtor could sell, without consequence, collateral subject to a security agreement with the knowledge that such an act violates the security agreement as long as the debtor did not have the specific intent

Application of this standard to the state court's factual findings demonstrates that the injury to Petralia was willful. As the state court found, Jercich knew he owed the wages to Petralia and that injury to Petralia was substantially certain to occur if the wages were not paid; and Jercich had the clear ability to pay Petralia his wages, yet chose not to pay and instead used the money for his own personal benefit. He therefore inflicted willful injury on Petralia.

2. *Maliciousness*

A "malicious" injury involves "(1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse."[36] In the present case, the state court found Jercich knew he owed Petralia the wages and that injury to Petralia was substantially certain to occur if the wages were not paid; that Jercich had the clear ability to pay Petralia the wages; and that despite his knowledge, Jercich chose not to pay and instead used the money for his own personal benefit. Jercich has pointed to no "just cause or excuse" for his behavior. Moreover, Jercich's deliberate and willful failure to pay was found by the state trial court to constitute

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to injure the creditor but instead had the specific intent to get the money for the debtor's own use.

[36] *In re Bammer*, 131 F.3d 788, 791 (9th Cir.1997) (en banc) (quotations omitted); *see Bailey*, 197 F.3d at 1000 (making it clear that our maliciousness standard – and in particular our "just cause and excuse" prong – survived *Geiger*); *but see In re Miller*, 156 F.3d at 606(Fifth Circuit holding that the "just cause or excuse" standard has been displaced by *Geiger* and collapsing the "willful" and "malicious" prongs into a single inquiry).

substantial oppression under California Civil Code § 3294, which by definition is "despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights."[37] We hold that these state court findings are sufficient to show that the injury inflicted by Jercich was malicious under § 523(a)(6).

V.

The debt in this case arose from willful and malicious injury caused by the debtor's tortious conduct. It is therefore excepted from discharge under 11 U.S.C. § 523(a)(6).

REVERSED.

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[37] Cal. Civ.Code § 3294(c)(2).

United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re George JERCICH, Debtor.
James A. Petralia, Appellant,

v.

George Jercich, Appellee.

BAP No. NC-98-1724-PRyMe.
Bankruptcy No. 86-52611-ASW.
Adversary No. 86-0556.

Argued and Submitted June 24, 1999.
Decided Jan. 7, 2000.

Thomas R. Duffy, Duffy & Guenther, Monterey, CA, for James A. Petralia.

George Jercich, San Jose, CA, pro se.

Before PERRIS, RYAN, and MEYERS, Bankruptcy Judges.

OPINION

PERRIS, Bankruptcy Judge.

Prior to bankruptcy, Appellee George Jercich ("Debtor") employed Appellant James A. Petralia ("Creditor") and failed to pay him all his wages. As a consequence, Creditor obtained a state court judgment against Debtor that determined, *inter alia*, that Debtor committed a tortious breach of the contractual covenant of good faith and fair dealing with respect to Creditor. This appeal raises the issue of whether a claim resulting from a breach of the implied contractual covenant of good faith and fair dealing, characterized by state law as tortious,

can be a willful and malicious injury, thus making the claim potentially nondischargeable under § 523(a)(6).[1] We conclude that it cannot and AFFIRM the bankruptcy court's decision that the debt is not excepted from discharge under § 523(a)(6).

FACTS

In 1984, Creditor prevailed in a suit against Debtor in California state court for unpaid wages, "waiting time" penalties pursuant to state statute,[2] interest and costs. In addition to compensatory damages, the state court awarded punitive damages for the tortious breach of the covenant of good faith and fair dealing implied as part of the parties' employment contract. Debtor appealed the state court judgment and the state appellate court affirmed.

After Debtor filed a chapter 7 bankruptcy, Creditor filed a complaint in the bankruptcy court alleging that his debt arose from a willful and malicious injury and was nondischargeable under § 523(a)(6). Creditor moved for summary judgment. The bankruptcy court denied Creditor's motion for summary judgment, and pursuant to the parties' agreement that judgment be entered for Debtor if

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[1] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330.

[2] Cal. Labor Code § 203 (West 1998) provides that "[i]f an employer willfully fails to pay . . . any wages of an employee who is discharged or who quits, the wages of the employee shall continue as a penalty from the due date thereof at the same rate until paid or until an action therefor is commenced. . . . "

the court denied Creditor's motion for summary judgment, found that the debt was dischargeable and entered judgment for Debtor. Creditor appeals.

ISSUE

Whether an obligation for tortious breach of the implied contractual covenant of good faith and fair dealing is the type of debt that may be excepted from discharge under § 523(a)(6).

STANDARD OF REVIEW

Whether a particular type of debt is nondischargeable is a question of law. *In re Kirsh*, 973 F.2d 1454, 1456 (9th Cir.1992). This Panel reviews a bankruptcy court's conclusions of law *de novo*. *In re P.R.T.C., Inc.*, 177 F.3d 774, 782 (9th Cir.1999).

DISCUSSION

Section 523(a)(6) excepts from discharge a debt that results from "willful and malicious injury by the debtor to another entity or to property of another entity." The parties focused on two arguments before the bankruptcy court: (1) whether a debt arising from a breach of the implied contractual covenant of good faith and fair dealing can be nondischargeable under § 523(a)(6), because that section excepts from discharge debts arising from tort, not contract, and (2) whether the state court findings are sufficient to establish that Debtor acted with the intent to injure Creditor consistent with the United States

Supreme Court's decision in *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998).

Although the bankruptcy court discussed both arguments at the hearing on Creditor's motion for summary judgment, it ultimately concluded that the state court findings did not establish that Debtor acted with the intent to injure Creditor. Because we conclude that a breach of the implied contractual covenant of good faith and fair dealing is not the type of tort that can give rise to a claim for nondischargeability under § 523(a)(6), and therefore that the bankruptcy court did not err in deciding that the debt is not excepted from discharge, we need not consider whether the state court findings are sufficient to establish that Debtor acted with the requisite intent.

Historically, the exception from discharge for debts arising from willful and malicious injury has been applied to tort claims, not contract claims. *See, e.g., Barbachano v. Allen*, 192 F.2d 836, 838 (9th Cir.1951) (applying the exception from discharge for willful and malicious injury under the Bankruptcy Act of 1898). That continues to be the majority approach and is the rule followed in the Ninth Circuit. *In re Riso*, 978 F.2d 1151, 1154 (9th Cir.1992); *In re Itule*, 114 B.R. 206, 211 n. 5 (9th Cir. BAP 1990). *See also* 4 Lawrence P. King, et al., *Collier on Bankruptcy* ¶ 523.12 (15th ed. Rev.1998); 3 William L. Norton, *Norton Bankruptcy Law and Practice 2d* § 47:44 (Rev.1998). Torts have traditionally been defined as obligations giving rise to liability that are imposed by law apart from and independent of enforcement of promises made between parties to a contract. W. Page Keeton et al., *Prosser and Keeton on Torts* § 92, at 655-56 (5th ed.1984). In

contrast, contract obligations are created to enforce promises to do or not to do something and are obligations "based on the manifested intention of the parties to a bargaining transaction." *Id.*

The problem in this case arises because the distinction between tort and contract liability is not always clear. In certain cases, a debtor's conduct may constitute both a breach of contract and a tort. The Ninth Circuit has made it clear that "[a]n intentional breach of contract is excepted from discharge under § 523(a)(6) only when it is accompanied by malicious and willful tortious conduct." *Riso*, 978 F.2d at 1154.

> [S]ection 523(a)(6) does not encompass a breach of contract claim unless the same act constitutes an intentional tort such as conversion. . . . Indeed, the Court of Appeals in *In re Geiger*, 113 F.3d 848 (8th Cir.1997) (en banc), *aff'd* 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998), rejected the broader definition of wilfulness, in part, because it would sweep breach of contract claims within the exception. *See id.* at 852 ("Indeed, we see no reason that a knowing breach of contract would not result in a judgment that would be exempt from discharge under this legal principle. Surely this proves too much.").

In re Mitchell, 227 B.R. 45, 52 (Bankr.S.D.N.Y.1998) (citations omitted).

We conclude that, where a debtor's conduct constitutes both a breach of contract and a tort, the debt resulting from that conduct does not fit within § 523(a)(6) unless the liability for the tort is independent of the liability on the contract. *See In re Krishnamurthy*, 209 B.R.

714, 720 (9th Cir. BAP 1997) *aff'd* 125 F.3d 858 (9th Cir.1997) (table) (affirming determination of nondischargeability under § 523(a)(6) where claim arose from torts independent of contract cause of action); *Itule*, 114 B.R. at 211 (affirming determination of nondischargeability under § 523(a)(6) where conduct giving rise to the claim was tortious apart from contractual duties); *Mitchell*, 227 B.R. at 52 (refusing to find a claim nondischargeable under § 523(a)(6) where the creditor failed to prove independent tortious conduct); *In re Thompson*, 166 B.R. 849, 853 (Bankr.N.D.Tex.1994) (citing *Riso* and suggesting that conduct must constitute an independent tort to give rise to a claim that the debt is nondischargeable under § 523(a)(6)). In other words, we adopt the traditional view of torts as liability imposed by law apart from and independent of enforcement of contractual promises.

A tort is independent if the conduct at issue would be tortious even if a contract between the parties did not exist. For example, in *Itule*, we affirmed the bankruptcy court's finding that a debt arising from conversion and trespass to chattels was nondischargeable under § 523(a)(6).[3] In *Itule*, the parties had a contractual relationship, but the debtor's conduct could have been

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[3] Conversion is defined as "an act or series of acts of willful interference, without lawful justification, with any chattel in a manner inconsistent with another's right, whereby that other person is deprived of the use and possession of the chattel." *Black's Law Dictionary* 333 (7th ed.1999). Trespass to chattels is "[t]he act of committing, without lawful justification, any act of direct physical interference with a chattel possessed by another." *Id.* at 1509.

tortious even if the contract between the parties did not exist. Likewise, the tort of fraud can exist outside of a contractual relationship. *See, e.g., Krishnamurthy,* 209 B.R. at 720.

Limiting the scope of § 523(a)(6) in this way will assure that ordinary breaches of contract, which are often willful, are not made nondischargeable by state laws that have sometimes extended tort liability beyond the traditional view. In our view, § 523(a)(6) was never intended to extend to claims that are in actuality claims for breach of contract, but which state law has denominated as torts.

"One of the fundamental policies of the Bankruptcy Code is the fresh start afforded debtors through the discharge of their debts." *Riso,* 978 F.2d at 1154. To effectuate this policy, exceptions to discharge are strictly construed against an objecting creditor and in favor of the debtor. *In re Chang,* 163 F.3d 1138, 1140 (9th Cir.1998); *In re Cole,* 226 B.R. 647, 654 (9th Cir. BAP 1998). The goal of providing debtors with a fresh start would be significantly impaired if § 523(a)(6) applied to except from discharge claims arising from breach of contract. *See Geiger,* 523 U.S. at 62, 118 S.Ct. 974. Financially distressed debtors often lack sufficient resources to pay all of their creditors and routinely breach contracts because they do not have the financial resources to perform. Failure to pay, even if willful, does not give rise to the type of liability that is nondischargeable under § 523(a)(6).

The state trial court found that Debtor's conduct amounted to a tortious breach of the covenant of good faith and fair dealing implied as part of his employment contract with Creditor. Although the parties dispute

whether such a claim is actually a tort,[4] we are bound by the California state court's characterization that the

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[4] Although, as a general rule, only contract damages are available when a party breaches the implied covenant of good faith and fair dealing, California law has recognized the existence of tortious breach of the covenant of good faith and fair dealing in certain circumstances. *See, e.g., Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 169 Cal.Rptr. 691, 620 P.2d 141 (1979) (where an insurance company breaches the covenant of good faith and fair dealing, the "special relationship" between an insured and an insurer supports imposition of tort liability for breach of the implied covenant of good faith and fair dealing). In reviewing the state court decision in favor of Creditor, the state appellate court expressly declined to decide whether a breach of the implied covenant of good faith and fair dealing could be tortious in the context of a claim for unpaid wages. *Petralia v. Jercich*, Super.Ct. No. 13101 (Cal.Ct.App. May 22, 1986). Nevertheless it affirmed the state trial court's award of punitive damages, which are available in tort actions, but not contract actions. The appellate court noted that the employment relationship between Debtor and Creditor resembled the "special relationship" between an insured and insurer. *Id.* The California Supreme Court later rejected this reasoning in *Foley v. Interactive Data Corp.*, 47 Cal.3d 654, 254 Cal.Rptr. 211, 765 P.2d 373, 395 (1988).

In *Foley*, the California Supreme Court held that "the employment relationship is fundamentally contractual, and several factors combine to persuade us that in the absence of legislative direction to the contrary contractual remedies should remain the sole available relief for breaches of the implied covenant of good faith and fair dealing in the employment context." *Id.* at 398. Subsequently, the California Supreme Court held that *Foley* "shall be given full retroactive effect as to all cases not yet final on January 30, 1989, the date that decision became final." *Newman v. Emerson Radio Corp.*, 48 Cal.3d 973, 258 Cal.Rptr. 592, 772 P.2d 1059, 1072 (1989) (en banc). In determining whether to give collateral estoppel effect to a state court judgment, " '[f]ederal courts must give to a state-court

breach constituted a tort. However, this does not change the outcome here, because we hold for purposes of a claim under § 523(a)(6) that the tort must be independent of the contract.[5]

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judgment the same preclusive effect as would be given that judgment under the law of the state in which judgment was entered.' " *In re Younie*, 211 B.R. 367, 373 (9th Cir. BAP 1997) (citation omitted). Because the judgment of the state appellate court in this case was filed on May 22, 1986, *Foley* is not applicable and we are bound by the state court's determination that Debtor's breach of the implied covenant of good faith and fair dealing was tortious.

[5] Creditor argues that because the state court found that Debtor committed a tort, we are prevented from examining the nature of the claim when determining whether it is excepted from discharge. We disagree. The federal courts have exclusive jurisdiction to determine dischargeability under § 523(a)(6). *See* § 523(c)(1). In making that determination, a bankruptcy court must go beyond the mere existence of a state court judgment and consider the nature of the debt. *See In re Comer*, 723 F.2d 737, 740 (9th Cir.1984). *See also In re Younie*, 211 B.R. 367, 373 (9th Cir. BAP 1997) (dischargeability of a debt under § 523(a)(2)(A) is a question of federal law that is governed by the Bankruptcy Code). For example, when determining whether the requisite fiduciary relationship exists under § 523(a)(4), which excepts from discharge debts for fraud or defalcation while acting in a fiduciary capacity, courts look to state law to determine if it creates a fiduciary duty, but then determine as a matter of federal law "[w]hether a relationship is a fiduciary one within the meaning of § 523(a)(4)[.]" *See, e.g., In re Stanifer*, 236 B.R. 709, 714 (9th Cir. BAP 1999). Similarly here, the court must look to state law to determine whether the claim constitutes a tort. If it does not, then the debt is dischargeable. If it does, the court must then determine whether the tort exists independent of a contract. If it does not exist independent of a contract, it is not the type of tort that is nondischargeable under § 523(a)(6).

The essence of Creditor's claim is that Debtor breached his contractual obligation to pay Creditor his wages. Because the implied contractual covenant of good faith and fair dealing, which is the basis of the state law tort, could not exist absent the parties' employment contract, Creditor's claim could not exist independent of Debtor's breach of his contractual obligation. We conclude that the claim, even though it was defined by state law as a tort claim, does not meet the requirements of § 523(a)(6) because it was, in substance, a claim arising from contract, not from an independent tort.

CONCLUSION

The tort of breach of the implied contractual covenant of good faith and fair dealing cannot be the basis of a debt nondischargeable under § 523(a)(6) because it is not a claim arising from an independent tort. We AFFIRM.

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JAMES PETRALIA

SUPERIOR COURT OF CALIFORNIA

COUNTY OF MONTEREY

JAMES PETRALIA,

Plaintiff,

v.

GEORGE JERCICH, INC., et al.,

Defendants.

_____/

AND RELATED CROSS-ACTIONS

_____/

CASE NO. M 13101

STATEMENT OF DECISION

(Filed Feb. 14, 1984)

This case came on regularly for trial before this Court on November 7, 1983. Plaintiff was represented by Thomas R. Duffy, DUFFY & MILGROM, Attorneys at Law, and Defendants were represented by William B. Daniels, HEISLER, STEWART & DANIELS, Attorneys at Law. Jury trial was waived by all parties.

By stipulation between counsel, plaintiff was allowed to amend his complaint at trial by filing a "First Amendment to Complaint" which added two new causes of action.

Counsel for defendants stipulated that, without admitting liability on the alter ego allegations in the complaint, any judgment against defendant George Jercich, Inc. would also be considered a joint and several judgment against George Jercich individually.

Both parties moved to amend to conform to proof following conclusion of the evidence. Both motions to amend were granted.

Plaintiff's motion to strike evidence re the second and third causes of action in the cross-complaint was denied.

After considering the evidence presented at trial, the Court finds the following:

Plaintiff James Petralia was an employee of defendant George Jercich, Inc., a real estate company performing mortgage broker services. Petralia's primary job for Jercich was to obtain investors to fund loans arranged by Jercich.

While there was conflicting evidence regarding which employment agreement applied in this case, this Court finds that the operative agreement was the written agreement dated June 16, 1981 (Plaintiff's Exhibit 3). All of the provisions of the June 16, 1981 agreement (hereafter referred to as the "employment agreement") continued to apply until plaintiff terminated his employment on January 11, 1983.

Petralia was to have been paid a salary, plus a commission for loans which were funded through his efforts. The commissions should have been paid on a monthly basis.

Jercich failed to pay Petralia his commissions as required by the employment agreement. In fact, as the testimony of other of Jercich's employees demonstrated, Jercich consistently failed to pay commissions to his other commissioned employees, as well as Petralia.

1. Complaint – First Cause of Action.

The following wages should have been paid in 1982, but were not:

(1) In June 1982, Petralia should have been paid $2,462.50;

(2) In October 1982, Petralia should have been paid $3,457.66;

(3) Beginning in November 1982, Petralia qualified for the "bonus" provisions contained in Paragraph 4 of the employment agreement. In November 1982, Petralia should have been paid $7,652.69;

(4) In December 1982, the last month of plaintiff's employment, Jercich should have paid Petralia $7,708.92.

Further, when plaintiff quit Jercich's employ on January 11, 1983, Petralia should have been paid vacation pay of $1,667.00. Jercich never made any attempt to pay Petralia his vacation pay.

Jercich had the clear ability to make these payments to Petralia, but chose not to. Instead, Jercich utilized funds from his company to pay for a wide variety of personal investments, including a horse ranch, rather than pay his employee.

The behavior of Jercich in this matter amounts to oppression within the meaning of C.C. §3294. Few, if any, areas of the law are more important than an employer's obligation to pay his employee's wages. California courts agree, and have time and again underscored the significance of an employer's failure to pay wages. (*See, e.g., Kerr's Catering Service v. Dept. of Ind. Relations* (1962) 57 Cal.2d 319, 325)

Jercich's failure to pay Petralia's commissions and vacation pay constitutes a willful failure to pay wages. Commissions are considered "wages" for purposes of the Labor Code. (Labor Code §200; *Quillian v. Lion Oil Co.* (1979) 96 Cal.App.3d 156, 162) Vacation pay has the same status, and is payable upon termination of the employee. (*Suastex v. Plastic Dress-up Co.* (1982) 31 Cal.2d 774, 784)

Jercich willfully failed to pay Petralia a total of $22,948.77 in back wages and vacation pay. The Court finds that plaintiff fully established a violation of Labor Code §203, and that plaintiff is entitled to waiting time penalties of 30 day wages. Petralia's total wages during his last month of employment, December 1982, were $9,342.64. Thus, defendant is assessed waiting time penalty wages of $9,342.64.

Further, the Court finds that the amounts defendant should have paid plaintiff were liquidated contract claims within the meaning of Civil Code §3287(a). Accordingly, plaintiff is entitled to pre-judgment interest of ten (10) per cent per annum on his back wages through the date of judgment. This amount is $2,539.39 through January 1, 1984, and $6.38 per day thereafter through the date of judgment.

2. Complaint – Second Cause of Action.

The court finds that Jercich, although always having the ability to do so, failed to pay his employee, Petralia, his due wages. This failure to pay was willful and deliberate and constituted substantial oppression entitling the Court to award punitive damages.

The best way to prevent this kind of abuse in the future is to assess adequate punitive damages against Jercich to serve as a deterrent both to him and to other like-minded employers. Jercich testified that his personal worth exceeded one million dollars. Under these circumstances, an award of $20,000 in punitive damages is appropriate.

3. Complaint – Third Cause of Action

Plaintiff established that defendant Jercich made an unsecured usurious loan to plaintiff at the rate of 20% per year. Defendant Jercich admitted during cross-examination that the loan was usurious. Treble damages are appropriate, in the amount of $1,397.28.

4. Cross-Complaint – Second Cause of Action.

Jercich failed to establish any facts which would support his second cause of action in the cross-complaint. Jercich admitted on cross-examination that he had an oral agreement with Petralia to have Petralia purchase the house at 7250 Hihn Road in Ben Lomond. There was never anything in writing to confirm this. Moreover, there was a conflict in the evidence with respect to the existence of the agreement itself.

Jercich failed to meet his burden of proof in establishing the existence of a binding and valid contract to sell the Hihn Road property to plaintiff. Even if he had, the contract would have been barred by the Statute of Frauds, which requires contracts to sell real estate to be in writing. (Civil Code §1624.4)

5. Cross-Complaint – Third Cause of Action.

Jercich failed to meet his burden of proof with respect to the third cause of action in his cross complaint. There were substantial conflicts in the evidence with regard to this cause of action, which the Court resolved in Petralia's favor.

Viewing the evidence in the light most favorable to Jercich, he established only an oral agreement to sell the Carmel Valley Road house to Petralia. There was never any writing reflecting this agreement, which invalidated it under the Statute of Frauds.

Even if the purported agreement had been enforceable under the Statute of Frauds, the Court finds that any obligation Petralia may have had to purchase the house was conditioned upon obtaining adequate financing. This condition was never satisfied. Jercich did not prove that Petralia failed to exercise good faith and diligence in attempting to satisfy this condition.

The Court also finds that Jercich did not prove that there was a separate agreement with Petralia to pay "carrying costs". If there was such an agreement, it was part of the agreement to purchase the house, and thus barred by the Statute of Frauds.

The Court finds that there were insufficient facts to justify estopping plaintiff from asserting the Statute of Frauds.

6. Conclusions

Plaintiff is entitled to judgment against defendants George Jercich, Inc., and George Jercich, the individual, jointly and severally, in the total amount, excluding costs and post-judgment interest, of $56,228.08. This amount includes pre-judgment interest to January 1, 1984. Plaintiff shall be entitled to costs and attorneys' fees to be submitted on a memorandum of costs.

Dated: 2/6/84 /s/ Robert A. O'Farrell
Honorable Robert A. O'Farrell
JUDGE OF THE SUPERIOR COURT

Supreme Court, U.S.
FILED
MAY 24 2001

No. 00-1632

In The

Supreme Court of the United States

GEORGE JERCICH,

Petitioner,

v.

JAMES PETRALIA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals In And For The Ninth Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED FOR REVIEW

Petitioner George Jercich had a pattern and practice of using nonpayment of wages to abuse his employees. As part of this pattern and practice, Petitioner caused harm to an employee, Respondent James Petralia, by intentionally not paying Mr. Petralia his wages, bonuses, and vacation pay, while loaning Respondent money at usurious rates. This reprehensible behavior was found to be intentionally tortious conduct by two different California courts and the Ninth Circuit Court of Appeals. Did the Court of Appeals err in finding that Petitioner had engaged in "willful and malicious conduct" which is nondischargeable under section 523(a)(6) of the Bankruptcy Code?

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OPINIONS BELOW

James Petralia v. George Jercich, Inc., et al., Unpublished Opinion, Sixth District Court of Appeals, State of California, filed May 22, 1986, reprinted in Respondent's Appendix. (Resp.App. 1)[1]

I. STATEMENT OF THE CASE

The Petition suggests that this case presents the question of whether liability for breach of an employment contract for failure to pay wages is nondischargeable in bankruptcy under 11 U.S.C. § 523(a)(6). (Pet. 2) Petitioner asserts that the floodgates of litigation will be opened and the wage priority provisions of 11 U.S.C. § 507(a)(3) rendered a nullity if the Ninth Circuit decision stands. (Pet. 12) According to Petitioner, this case involves an issue of national importance as it will "affect virtually every employer that files for bankruptcy in this nation." (Pet. 14)

However, the Ninth Circuit opinion does not hold what Petitioner claims it does. The Ninth Circuit's decision regarding non-dischargeability followed a final California state court judgment, affirmed on appeal by the California Fourth District Court of Appeal, which found that Petitioner's actions in not paying wages to Respondent were part of an ongoing pattern and practice by Petitioner of delaying and evading his obligations to his

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[1] As there is an appendix attached to Respondent's brief, for convenience Petitioner's appendix shall be referred to as "Pet.App.", while Respondent's appendix shall be referred to as "Resp.App."

employees, resulting in a finding that Petitioner had committed an intentional tort under state law, not merely a knowing breach of contract. (Pet.App. 3)

Unique factual issues are present in this case, as the case is based upon a 17 year old state court decision which, according to Petitioner, would be decided differently today as California law has changed in this area. The unusual factual setting renders unnecessary additional review by this Court.

II. STATEMENT OF THE FACTS

Respondent Jim Petralia was an employee of Petitioner George Jercich. The facts found by the California courts were that Petitioner consistently and intentionally failed to pay Respondent his wages, in a setting where Petitioner had a long history of belated payment of wages, which sometimes were paid as much as 5 months late. (Resp.App. 6) At the same time, Petitioner used the opportunity to loan money to Respondent at usurious rates (20%). (Pet.App. 30)

Petitioner refused to pay Respondent his vacation pay upon termination of employment. When another employee resigned and asked for the vacation pay due him, Petitioner told him to "shine it," meaning that he was not going to pay it. Petitioner characterized this as an "agreement" that "there would be no vacation pay." (Resp.App. 7) The trial court found that Petitioner never made any attempt to pay Respondent's vacation pay. (Pet.App. 28)

Respondent's requests for payment of his wages were either ignored or stalled, or paid when Petitioner "got around to it." During the period of time that Petitioner chose not to pay Respondent's wages, Petitioner had the "clear ability" to pay the wages, but chose not to. (Resp.App. 7)

During this time, Petitioner paid himself bonuses of between $70,000 and $140,000, and made additional payments to a fictional entity consisting of Petitioner and his wife, to other business concerns owned by Petitioner, and to personal creditors of himself and his wife. Beneficiaries of these payments included a horse ranch and Petitioner's parents. (Resp.App. 7)

In concluding that Petitioner had committed the intentional tort of breach of the covenant of good faith and fair dealing, the trial court determined that the behavior of Petitioner constituted "oppression" within the meaning of Civil Code § 3294[2], noting that:

> "Few, if any, areas of the law are more important than an employer's obligation to pay his employee's wages. California courts agree, and have time and again underscored the significance of an employer's failure to pay wages." [citations omitted] (Pet.App. 29)

In California, a finding of "oppression" is a factual finding that Petitioner committed "despicable conduct

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[2] California Civil Code § 3294(a) provides for imposition of punitive damages only "[i]n an action for the breach of an obligation not arising from contract where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud or malice [.]" (Cal. Civil Code § 3294(a))

that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights." (Cal. Civil Code § 3294(c)(2))

On appeal, the California appellate court affirmed the decision of the trial court in every respect, and held that there was ample evidence to conclude not only that Petitioner intentionally failed to pay wages due, but also that Petitioner did not believe in good faith that he was entitled to withhold them, characterizing Petitioner's conduct as part of an ongoing pattern and practice of delaying and evading his obligations to his employees. (Resp.App. 7) As the California appellate court noted:

> "The trial court was entitled to conclude that Jercich's withholding of Petralia's wages had nothing to do with any belief by Jercich in his entitlement to do so, but was instead *part of an ongoing pattern and practice of delaying and evading his obligations to his employees.* The evidence here went well beyond the showing necessary to support waiting time penalties under Labor Code section 203. Assuming that a defense of "good faith" may in a proper case be allowed, the trial court acted well within its province as finder of fact in rejecting such a defense here." (emphasis supplied) (Resp.App. 7-8)

III. REASONS FOR DENYING CERTIORARI

A. THE DECISION BELOW DOES NOT RAISE THE QUESTION PRESENTED BY THE PETITION

The decision below did not decide the question which Petitioner proffers as ripe for decision by this

Court. While Petitioner describes the issue as whether liability for breach of an employment contract by failing to pay an employee wages is nondischargeable under 11 U.S.C. § 523(a)(6), Petitioner's statement of the question ignores the fact that the Ninth Circuit specifically held that a knowing breach of an employment contract, without more, would not satisfy the requirements for nondischargeability under section 523(a)(6). (Pet.App. 7) Instead, the Ninth Circuit went on to hold that, where conduct which would constitute a breach of contract is concerned, in order to be found nondischargeable the conduct must also constitute a wilful and malicious tort. (Pet.App. 7)

The case below involved two basic questions: (1) whether the Bankruptcy Appellate Panel of the Ninth Circuit erred in announcing a new test for nondischargeability conduct under 11 U.S.C. § 523(a)(6) by adding a requirement, not found in the statute, that the conduct involved must be "tortious even if a contract between the parties did not exist" (Pet.App. 5, n.10); and (2) whether Petitioner's conduct, as found by the state court judgment, was tortious conduct which involved a "willful and malicious injury." (Pet.App. 11-15)

The Ninth Circuit first determined that neither the language nor the policies of section 523(a)(6) supported the additional requirement urged by the BAP. (Pet.App. 6-8)

The Ninth Circuit went on to hold that where the conduct in question involves a breach of contract, in order to be found nondischargeable the conduct must also involve "tortious conduct" that gives rise to "willful

and malicious injury." (Pet.App. 7) In the opinion of the Ninth Circuit, the state court determination that the debtor had committed an intentional tort, which, under state law, is defined as "despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights" was sufficient to determine that the Petitioner's conduct was tortious. (Pet.App. 10) Going further, the Ninth Circuit determined that the "willful" requirement was met by the findings in the state court judgment (Pet.App. 13), and that "malicious" injury was demonstrated by the state court's holding that Petitioner's conduct constituted "substantial oppression" under California Civil Code § 3294. (Pet.App. 14-15)

Although Petitioner asserts that the Ninth Circuit's holding was actually premised upon a decision regarding whether, under California law, the willful failure to pay wages in these particular circumstances was a violation of a fundamental public policy and thus constituted a tort (Pet. 5), Petitioner ignores the fact that both California courts, the trial court and the appellate court, already determined that an intentional tort had occurred. (Pet.App. 30) Petitioner was found to have tortiously breached the covenant of good faith and fair dealing (Pet. 3), which under California law at the time (1984) was deemed to constitute a tort. (Pet.App. 8, n.17)

The Ninth Circuit's opinion is much less complex and far-reaching than Petitioner suggests. In fact, the Ninth Circuit did not independently and improperly determine whether a tort was involved; it simply found that an intentional tort had occurred under state law, which indeed was the conclusion reached by both California

courts which had considered the issue. The Ninth Circuit's recognition that an intentional tort had occurred under state law is not remarkable in nondischargeability jurisprudence and does not merit review by this Court.

B. THE FLOODGATES OF LITIGATION WILL NOT BE OPENED BY THE NINTH CIRCUIT'S OPINION

Petitioner posits a parade of horribles which would supposedly occur if the Ninth Circuit's opinion is not reviewed and reversed, arguing that the floodgates of litigation will open and federal bankruptcy courts will be inundated as hordes of unpaid employees file non-dischargeability cases with every bankrupt employer. (Pet. 7) Petitioner then goes on to suggest that the wage claim priority provisions of 11 U.S.C. § 507(a)(3) will be "rendered a nullity", if the Ninth Circuit's decision is not reversed.

Petitioner's argument is fundamentally flawed, as it ignores the fact that in order to be found nondischargeable the employer's conduct will have to rise to the level of an intentional tort, committed "maliciously" and "wilfully", which will be a very heavy burden in the usual case. An employee must prove substantially more than the fact that the employer knowingly did not pay wages when due. If, and only if, an employee can prove that the employer has stepped over the line and has engaged in intentionally tortious behavior, *e.g.*, using nonpayment of wages as a bludgeon to oppress his employees while lending them money at usurious rates, will the conduct be deemed nondischargeable.

It is likely that this standard will be satisfied in very few cases. It bears noting that as no attorney's fee awards are possible in section 523(a)(6) cases, no external systemic incentives exist to encourage such litigation. As a practical matter, these cases will only be brought where the employer's conduct is so egregious that it rises to the level of an intentional tort under state law, and, even then, will only be brought where the amount of the unpaid wages is sufficient to justify the litigation. It is submitted that the combination of these circumstances occurring will be rare.

As an example, under Petitioner's analysis, if the case at bar were being decided today, given the present state of California law (in Petitioner's view[3]), Petitioner's conduct would not constitute a tort. Assuming Petitioner's conceptual construct, this case would not be successful today, either in California state court or in bankruptcy court. Thus, Petitioner's proffered vision of uncontrollable bankruptcy litigation is conceptually flawed, as measured against the facts of this very case.

For the same reasons, Petitioner's asserted claims regarding the effect on 11 U.S.C. § 507(a)(3) are flawed. Section 507(a)(3) provides for a priority for certain wage claims earned within 90 days of filing the bankruptcy petition, but only to the extent of $4,300. (11 U.S.C. § 507(a)(3)) Petitioner argues that, if wage claims which also involve intentionally tortious behavior by the employer are exempted from discharge, the provisions of section 507(a)(3) will be rendered a nullity.

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[3] As discussed, *infra*, at III, C.

This argument contains no more logic than a setting where an employer has intentionally defrauded an employee into entering into a fraudulent employment contract. Notwithstanding the availability of section 507(a)(3)'s priority wage claim provisions, there is no reason to believe that the defrauded employee would not be able to pursue an adversary proceeding to determine nondischargeability under 11 U.S.C. § 523(a)(2)(A). The availability of nondischargeability treatment for fraudulent employment contracts has hardly resulted in rendering section 507(a)(3) priority wage claims a nullity, any more than does the availability of nondischargeability treatment for situations in which an employer has behaved in an intentionally tortious manner towards his employee by using unpaid wages as a mechanism for abusing the employee. Whether certain limited unpaid wages are accorded priority under section 507(a)(3) has no apparent logical relationship to nondischargeability under section 523(a)(6).

C. REVIEW OF THIS CASE WOULD BE IMPROVIDENT BECAUSE THE CASE IS BASED UPON UNUSUAL FACTS WHICH ARE UNLIKELY TO BE REPEATED AND, ACCORDING TO PETITIONER, THE UNDERLYING LAW IS NO LONGER IN EFFECT

This case is based upon unusual facts which should not serve as the basis for a decision by this Court. The California state court determination that Petitioner committed an intentional tort occurred 17 years ago (1984). (Pet.App. 32) The state court judgment became final

when it was affirmed on appeal 15 years ago (1986). (Resp.App. 1)

As Petitioner notes, in 1988 the California Supreme Court decided a major employment law case, *Foley v. Interactive Data Corporation*, 47 Cal.3d 654, 696 (1988), but *Foley* was decided long after the state court judgment in this case was final. *Foley* was a wrongful termination case, not a wage violation case. Nevertheless, Petitioner broadly asserts that the holding in *Foley* "abrogated the availability of punitive damages in the employment setting." (Pet. 4) Respondent believes that Petitioner's view of *Foley* is overly expansive, as the California Supreme Court noted in *Foley* that violations of public policy, such as occurred in the case at bar, may still be considered torts under California law. (*Foley, supra*, 47 Cal.3d 654, 693, n.30)

Petitioner notes that *Foley* was made retroactive to cases then pending. (Pet. 4) However, the import of Petitioner's statement is unclear, as, notwithstanding such retroactivity, Petitioner apparently does not suggest that *Foley*'s holding would apply to reverse judgments, such as this case, which became final long before *Foley* was decided.

In the case below, the Ninth Circuit found that Petitioner's reprehensible conduct was an intentional tort under California law. (Pet.App. 8-10) Respondent concurs with the Ninth Circuit's reasoning, but also points out that the Ninth Circuit's reasoning was unnecessary to its decision. Both the California trial court and the California appellate court determined that Petitioner had committed an intentional tort under California law. (Pet.App. 30)

The California judgment became final in 1986. The collateral estoppel and full faith and credit doctrines enunciated by this Court in *Grogan v. Garner*, 498 U.S. 279, 284-85, n.11, 111 S.Ct. 654, 658, n.11, 112 L.Ed.2d 755 (1991), would, in any case, prevent re-examination of the conclusions reached by the California courts which were embodied in a final, non-appealable, state court judgment (now 15 years old).

Petitioner's argument that this case would be decided differently today in post *Foley* California does not provide a basis for review by this Court, but instead, if true, merely demonstrates that the factual underpinnings to this case are outdated. Given this unique factual setting, this case does not clearly or directly present any significant issue regarding nondischargeability under section 523(a)(6), nor is it a case of national importance, as the state law in this area, according to Petitioner, has substantially changed since the underlying state court case was decided.

D. THE NINTH CIRCUIT'S OPINION BELOW IS CONSISTENT WITH THIS COURT'S OPINION IN *KAWAAUHAU V. GEIGER*

Petitioner suggests that the opinion below is a departure from this Court's reasoning in *Kawaauhau v. Geiger*, 523 U.S. 57, 188 S.Ct. 974, 140 L.Ed.2d 90 (1998). (Pet. 8-9) However, the opinion by the Ninth Circuit is wholly consistent with the teachings of *Geiger*.

Geiger, a medical malpractice case, distinguished in nondischargeability cases between negligent or reckless

torts (dischargeable) and intentional torts (nondischargeable). (*Kawaauhau v. Geiger, supra,* 523 U.S. 57, 61-62, 118 S.Ct. 974, 977) While Petitioner asserts that this case is an unwarranted incursion into the *Geiger* doctrine, in fact just the opposite is the case.

The behavior of Petitioner in using nonpayment of employee wages with the intent to "oppress" his employee, which was part of a pattern and practice by Petitioner of delaying and evading his obligations to his employees, constituted behavior which was so egregious and so at odds with fundamental California public policy that Petitioner was found to have committed an intentional tort under California law. That finding is entirely consistent with *Geiger's* requirement that nondischargeability treatment under section 523(a)(6) be limited to intentional torts.

Unless this Court wishes to involve the bankruptcy courts in defining anew the field of intentional torts, a task that has already been amply performed by existing state decisional and statutory laws, no need exists for review of the opinion below. Even if the Court wished to further explore this subject, this particular case, with its unusual and arguably outdated factual setting, would prove an inappropriate vehicle for doing so.

IV. CONCLUSION

For all of the above reasons, Mr. Jercich's petition for writ of certiorari should be denied.

Respectfully submitted,

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

JAMES PETRALIA,

Plaintiff, Cross-defendant and Respondent,

v.

GEORGE JERCICH, INC., et al., Defendants, Cross-complainants and Appellants.

From August 1980 until January 1983 plaintiff Petralia was employed as an account executive in the loan brokerage business owned and operated by defendants George Jercich, Inc., and George Jercich.[1] He quit that employment on January 10, 1983. On February 28, 1983, he filed a complaint against defendants for wages alleged to be due and unpaid. As amended, the complaint charged Jercich with failing to pay wages in breach of the employment contract; usurious lending in violation of article XV, section 1 of the California Constitution; and breach of the covenant of good faith and fair dealing through this and other conduct allegedly in violation of Jercich's obligations as an employer. Plaintiff sought

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[1] The parties have made no material distinction between the two defendants for purposes of this appeal. By stipulation, any judgment against the corporation is binding on both defendants. Accordingly references here to "Jercich" may be taken to include both defendants.

recovery of unpaid wages, "waiting time" penalties under Labor Code section 203, prejudgment interest, punitive damages under Civil Code section 3294, treble damages on the usury cause of action, and attorney fees.

Defendants denied liability and defendant George Jercich, Inc., cross-complained, alleging that Petralia was soliciting former clients in violation of the employment agreement, that he had breached an agreement to indemnify defendants in connection with certain property in Ben Lomond, California, and that he had breached a separate agreement to pay certain "carrying costs" in exchange for the right to occupy certain property in Carmel Valley, California.

The parties indicate that the claim for solicitation of former clients was settled; in any event it was not in issue at trial and is not in issue here. As presented at trial and on this appeal, the cross-action consisted of two interrelated claims, namely that Petralia was obligated to pay "carrying costs" for the time he occupied the Carmel Valley property and that he was liable for failure to purchase that property as he had allegedly promised to do.[2]

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[2] The record contains no formal pleading by Jercich of a binding contract for purchase of the Carmel Valley property, or of any breach of such a contract. The cross-complaint alleged only as "occupancy agreement" and referred to a statement by Petralia that "he desired to purchase said [Carmel Valley] property and . . . would attempt to secure a loan for the purchase thereof . . . " The allegations of a purchase agreement were, however, in issue at trial, and we therefore accept them as properly before us.

The matter was tried to the court sitting without a jury, and resulted in a judgment wholly favorable to Petralia on both his complaint and the cross-complaint. This appeal is timely, having been filed within thirty days of the denial by operation of law of defendants' motion for new trial. (Cal. Rules of Court, rule 3(a); Code Civ. Pro., § 660.)

Jercich contends that the trial court erred in awarding "waiting time" penalties, punitive damages, and attorney fees. With respect to the cross-action, Jercich contends that it was error not to enforce the alleged agreements for the occupancy and purchase of the Carmel Valley property.

Many of defendants' arguments rest on the supposed insufficiency of the evidence to support the trial court's findings. Having reviewed the record we are satisfied that ample evidence exists to support each of the questioned findings. Defendants' contentions are little more than a reargument of the evidence and an invitation for us to substitute our interpretation for that of the trial judge. This invitation overlooks our proper function, which is to decide issues of law. (9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, § 241, pp. 246-247.) In any case, the present record is replete with evidence in support of the trial court's findings and any argument predicated on alleged error in that regard is futile.

I
AMPLE EVIDENCE SUPPORTED THE AWARD OF "WAITING TIME" PENALTIES UNDER LABOR CODE SECTION 203

Jercich first contends that the trial court erred by awarding "waiting time" penalties under Labor Code section 203. He asserts that he believed he had the right under the "oral occupancy agreement" alleged in the cross-complaint to set off Petralia's commissions against the "carrying costs" on the Carmel Valley property, and that therefore his failing to pay Petralia was not willful and not a violation of section 203. This argument is without merit.

Labor Code section 202 provides that wages are due seventy-two hours after an employee gives notice that he is quitting his employment. Section 203 provides that if an employer "willfully" fails to pay any wages due a discharged or quitting employee, the wages "shall continue . . . from the due date thereof at the same rate until paid or until an action therefore is commenced; but such wages shall not continue for more than 30 days." The purpose of the section is "to compel the prompt payment of earned wages" (*Barnhill* v. *Robert Saunders & Co.* (1981) 125 Cal. App. 3d 1, 7) and thus "to protect the employee and to promote the welfare of the community" (id., quoting *Manford* v. *Singh* (1919) 40 Cal.App. 700, 702-703).

In *Barnhill, supra,* an employer had withheld wages in the mistaken belief that it was entitled to do so under principles of setoff. The court held that the employer was not subject to the waiting time penalty of section 203 because his conduct did not appear to have been "willful" within the meaning of the statute. Jercich relies on

that holding in arguing that his own conduct here was not such as to justify assessment of a waiting time penalty. In *Barnhill*, however, it was not contended that the employer had acted otherwise than in good faith in claiming a setoff against the employee's wages. (Id. at p. 8.) The law with respect to such setoffs was uncertain. (*Ibid.*) Apparently, there was no dispute about the employer's belief that it was entitled to withhold the wages. (*Ibid.*)

In contrast to *Barnhill*, the present case includes an express finding by the trial court of a willful refusal to pay wages. That finding is supported by substantial evidence.

In the first place, it is evident that Jercich in fact had no right to unilaterally set off an employee's debt against wages owed to that employee. The *Barnhill* court explicitly held that "an employer is not entitled to a setoff of debts owing it by an employee against any wages due that employee." (*Id.* at p. 6.)[3] Accordingly Jercich's position comes down to a contention that his withholding of Petralia's wages was not willful because he believed he had a valid claim against Petralia as well as the legal right to set that claim off against Petralia's wages.

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[3] Nor would Jercich's withholding of all of Petralia's wages be any less objectionable if there existed, as Jercich contends, an agreement to offset Petralia's commissions against carrying costs on the Carmel Valley property. Assuming such an agreement could excuse withholding the *commissions* Petralia had earned, it would not justify Jercich's refusal to pay the vacation pay and flat salary for January which were also due and unpaid.

The willfulness required for imposition of a waiting time penalty under Labor Code section 203 need not consist of "a deliberate evil purpose to defraud workmen of wages which the employer knows to be due." (*Barnhill, supra,* at p. 7.) "As used in section 203, 'willful' merely means that the employer intentionally failed or refused to perform an act *which was required to be done.*" (Id. at 7, citing Davis v. Morris (1940) 37 Cal, App. 2d 269, 274, original emphasis.)

Here, the evidence supports a finding not only that Jercich intentionally failed to pay wages due, but also that Jercich did not believe in good faith that he was entitled to withhold them. Petralia testified that Jercich acknowledged the debt and promised to attempt to make at least a partial payment, on the day Petralia announced he was quitting. Moreover, Jercich had a long history of belated payment of Petralia's wages. Throughout the period of Petralia's employment Jercich knew that commissions constitute wages, yet Petralia's commissions were paid as much as five months late. A current employee of Jercich testified that during the relevant period payments were late about three-quarters of the time. Petralia said that collecting commissions " seemed to be a problem every time." His requests for payment were either ignored or stalled, and he was paid "whenever they got around to it."

Jercich's own testimony was that commissions were paid when there was "cash available" for that purpose. However during most of Petralia's employment Jercich was paying himself a salary of $6,250 per month. And although his salary was supposedly "suspended" during the period when Petralia earned most of the commissions

at issue here, Jercich paid himself a "bonus" for that period of either $70,000 or $140, 000. Additional payments were made to a fictional entity consisting of Jercich and his wife, to other business concerns owned by Jercich, and to personal creditors of himself and his wife. Beneficiaries of these payments included a horse ranch and Jercich's parents.

Jercich testified that it was a company policy to pay employees for accrued vacation upon termination of employment. Yet when another employee resigned and asked for the vacation pay due him, Jercich told him to "shine it," meaning that he was not going to pay it. Jercich characterized this as an "agreement" that "there would be no vacation pay." He did not testify that he reached any similar agreement concerning vacation pay with Petralia. Instead he said that he "refused to pay [Petralia] one penny for anything until I determined whether or not I owed him any money, or if he, in fact, owed us money."

The trial court was entitled to conclude that Jercich's withholding of Petralia's wages had nothing to do with any belief by Jercich in his entitlement to do so, but was instead part of an ongoing pattern and practice of delaying and evading his obligations to his employees. The evidence here went well beyond the showing necessary to support waiting time penalties under Labor Code section 203. Assuming that a defense of "good faith" may in a proper case be allowed, the trial court acted well within

its province as finder of fact in rejecting such a defense here.[4]

II.

THE AWARD OF BONUS COMMISSIONS WAS SUPPORTED BY SUFFICIENT EVIDENCE

Jercich next argues that the trial court erred in awarding "bonus commissions." It is undisputed that such commissions were called for under the written employment agreement of June 16, 1982. Jercich contends, however, that he reserved the absolute power to adjust Petralia's salary or commission schedule, and that he "cancelled" the bonus program in an exercise of this power. He testified that he did this by telling the account executives that the provision in question "was not going to be enforced."

Plaintiff recalled no effort by defendant to declare the bonus program suspended and understood it to remain in effect throughout the latter months of his employment. Another former employee of defendants testified that he was never told the plan was suspended or cancelled. Yet another employee, who was still employed by defendants, testified that Jercich made no statement to him that the bonus program was cancelled. Jercich himself volunteered the testimony that he was unable to find evidence to support the cancellation.

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[4] Unlike the employer in *Barnhill, supra*, Jercich cannot point to any legal uncertainty about his right to exercise setoff, because *Barnhill* itself had resolved that question adversely to his position some fifteen months before the instant dispute arose.

The trial court was entitled to find that the program remained in effect.

Jercich also contends that Petralia's failure to include the bonus commissions in his original demand for wages somehow precluded their being awarded in the judgment. No authority is cited for this proposition. It is offered as nothing more than a factual contention which the trial court was free to reject.

The finding that Petralia was entitled to an award of bonus commissions will not be disturbed.

III

THE TRIAL COURT DID NOT ERR IN AWARDING PUNITIVE DAMAGES UNDER CIVIL CODE SECTION 3294

The trial court awarded $20,000 in punitive damages under Civil Code section 3294. Jercich contends that this was error. The precise basis for this argument is not clear. He emphasizes that punitive damages are only awardable under section 3294 "[i]n an action for breach of an obligation *not arising from contract.*" However he concedes that where an action sounds in tort as well as contract, punitive damages are recoverable. (See 1 Within, Summary of Cal. Law (8th ed. 1973) Contracts, § 644, pp. 548-549)

The complaint contained a count for breach of the covenant of good faith and fair dealing. Such a breach may constitute a tort. (*Egan* v. *Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d. 809, 818; see *Genial Distributing Co.* v. *Beck & Co.* (1985) 172 Calliope.3d 1020, 1035-1036.) Jercich does not argue that this theory was inapplicable to the facts of this case, and we therefore do not decide the

applicability of that theory to a claim for willful failure to pay wages. (See 9 Within, Cal. Procedure (3d ed. 1985) Appeal, § 479, pp. 469-471.) We do observe that the situation presented here more closely resembles the "special relationship" between an insured and a third-party insurer, which supported imposition of tort liability and punitive damages in *Egan, supra,* than it does the relationship of manufacturer and distributor, which was held not to support an implied-in-law covenant in *Genial, supra.*[5]

Jercich's sole argument concerning punitive damages appears to be that the evidence did not support the trial court's finding of "substantial oppression" in Jercich's failure to pay Petralia's wages. Based on the evidence summarized above we are satisfied that this finding is supported by substantial evidence and that the award of punitive damages should be left undisturbed.

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[5] Nor is there before us any contention that the "waiting time" penalties provided by Labor Code section 203 are the exclusive remedy for a refusal to pay wages. While we do not reach that issue, we observe that similar contentions have been rejected in other contexts, at least in the absence of some indication that the Legislature intended the statutory remedy to be exclusive. (See *Commodore Home Systems, Inc.* v. *Superior Court* (1982) 32 Cal.3d 211, 221 [punitive damages available in job discrimination action under Fair Employment and Housing Act]; *Hansel* v. *Singer Co.* (1982) 138 Cal.App,3d 290, 304, 305 [common law remedies not foreclosed by Labor Code provisions governing discharge for complaint about unsafe conditions or by Workers' Compensation Act].)

IV

NO ERROR APPEARS IN THE AWARD OF ATTORNEY'S FEES

The written employment contract between Petralia and Jercich contained a paragraph which, in essence, prohibited Petralia from soliciting Jercich customers after terminating his employment with Jercich. Included in that paragraph is the following sentence: "Provided [Petralia] violates this provision, [Petralia] shall be liable to [Jercich] for punitive and special damages and [Jercich's] court costs and attorney's fees." Both parties prayed for attorney's fees in their respective pleadings. The judgment awarded fees to Petralia.

Jercich contends that the award of attorney's fees was erroneous because the contract provided for such an award only in litigation over the non-competition clause. The cross-complaint contained a claim arising from this clause, but we are advised that it was settled before trial. In any event the record established that the non-competition provision was not in issue at trial.

The fee award appears to be based on Civil Code section 1717, subdivision (a), which provides in relevant part: "Where a contract provides for attorney's fees, such provision shall be construed as applying to the entire contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract."

The contract involved here contains no reference to legal representation during its negotiation and there is no contention that the parties were in fact represented. Accordingly, if section 1717 applies the attorney's fee

clause in the noncom petition provision shall be construed as applying to the entire contract.

Jercich invites us to hold that section 1717 does not apply because the Legislature did not have contracts such as the present one in mind when, in 1983, it enacted the pertinent amendment to that section. Jercich directs us to no ambiguity or constitutional infirmity in the statute. No argument is made, for example, that the amendment to section 1717 cannot constitutionally be applied to a contract entered before its effective date. In these circumstances we discern no basis for limiting the effect of the statute.

We also reject the suggestion, raised for the first time in Jercich's reply brief, that the parties' settlement of the noncom petition cause of action somehow operated to retroactively bring the employment agreement within the exception to section 1717. We are unable to discern any basis in law or logic for such a contention, particularly since it is unaccompanied by citations to authority.

Defendants have demonstrated no error in the award of attorney's fees.

V

THE TRIAL COURT DID NOT ERR IN REFUSING TO ENFORCE THE AGREEMENTS ALLEGED IN THE CROSS-COMPLAINT

Jercich contends that the trial court was required to find in his favor with respect to the alleged agreements by Petralia to pay "carrying costs" on the Carmel Valley property, and to purchase that property.

The trial court found that Jercich did not prove the existence of a separate agreement for payment of "carrying costs," and that "[i]f there was such an agreement, it was part of the agreement to purchase the house, and thus barred by the Statute of Frauds." The court also resolved in Petralia's favor the evidentiary conflicts which existed in connection with these claims. Thus the court found, at least by implication, that no occupancy agreement existed.

This finding is supported by substantial evidence. Petralia flatly denied entering into such an agreement, and Jercich's own testimony was far from compelling. At trial he asserted that the "occupancy agreement" was a separate transaction from the purchase agreement, but in deposition he had insisted that "it was all rolled up into one verbal agreement." Asked in deposition whether he could offer any reason for not reducing the occupancy agreement to writing, Jercich replied, "Nope."

Similar infirmities attended Jercich's attempt to prove an enforceable agreement for the sale and purchase of the Carmel Valley property. He testified that the deal was reached in September 1982, before Petralia moved into the house; however in a letter dated September 27 he referred to the transaction as "a proposed sale. . . . " He testified at one point that the consideration for Petralia's entry into the deal was that Petralia would be relieved of obligations he supposedly had assumed under another (oral) real estate agreement. Elsewhere, however, Jercich conceded that the Carmel Valley deal was proposed by him as an inducement to keep Petralia from quitting his job. Furthermore Jercich testified unequivocally in deposition that the deal was never reduced to writing and that

the written deposit receipt which Petralia signed was intended solely to permit Petralia to seek a loan. The trial court was entitled to discount Jercich's testimony at trial and to conclude that no enforceable contract was ever entered.

The trial court also found that any performance due from Petralia in connection with the Carmel Valley property was excused by failure of a condition precedent, namely Petralia's obtaining adequate financing. Jercich contends that this finding is unsupported by the evidence and rests on an erroneous understanding of the law affecting contractual conditions. The evidentiary argument rests on the erroneous proposition that the trial court was required to interpret the deposit receipt dated September 20, 1982. This argument fails because the trial court found in effect that the deposit receipt was not a contract and that if the parties had an agreement it was oral. The court's findings (in the alternative) about the terms of the agreement do not depend upon the deposit receipt, and nothing in this record would compel us to overturn those findings.

Jercich argues that the financing "condition" should have been interpreted as a covenant such that Petralia's failure to procure financing or his repudiation of the agreement constituted an actionable breach. However, any error in this regard would be harmless since, as we have already observed, the evidence amply supports the trial court's alternative determinations that there was no contract and that any contract which might have arisen would have been wholly oral and therefore unenforceable. Moreover, as appellant concedes, the trial court's silence on these issues constituted an implied finding that

Petralia did substantially perform all conditions on his part to be performed. (See 9 Within, Cal. Procedure (3d ed. 1985) Appeal, § 268, pp. 276-277.) There was considerable conflict in the evidence as to what Petralia did in connection with financing, and what he was required to do under the alleged agreement. No cause for reversal appears here.

The judgment is affirmed.

Anderson, P.J.

We concur:

Poche, J.

Channell, J.

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